

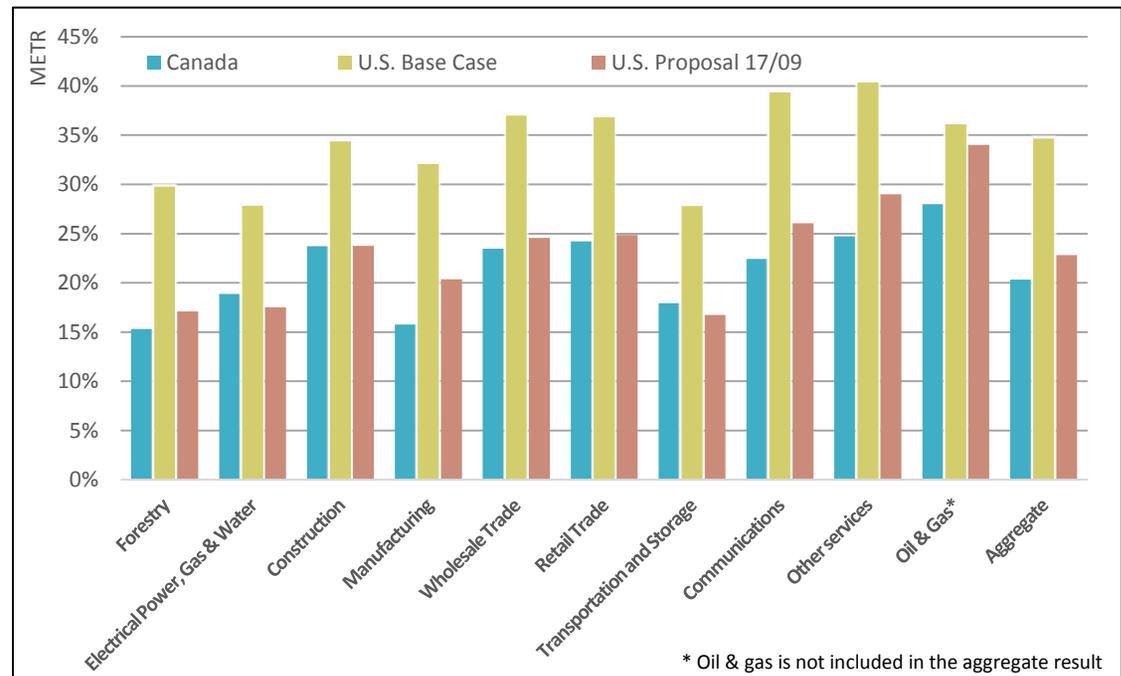
## REPUBLICANS REVEAL PROPOSED TAX OVERHAUL

The White House and Congressional Republicans have revealed their much-anticipated proposal for reform of the U.S. personal and corporate tax systems. The proposal titled, “UNIFIED FRAMEWORK FOR FIXING OUR BROKEN TAX CODE” outlines a number of central policy changes, which will significantly alter the U.S. corporate tax system. The proposal includes a top federal marginal rate reduction for the sole proprietorships, partnerships and S corporation—small business equivalents—from 39.6% to 25% (state income tax rates would no longer be deductible). Large corporations would also see a meaningful federal rate reduction given the proposed drop in the federal corporate income tax rate from 35% to 20%. Additionally, the proposal includes a generous temporary measure intended to stimulate investment, full capital expensing for machinery with a partial limitation of interest deductions.

**Taken together the rate reduction and expensing for machinery will significantly reduce the large corporate METR and taxes for US corporations.**

As the figure above illustrates under the proposal the U.S. aggregate METR would drop from the current 34.6% to 22.8%, bringing the U.S. further inline with the G7 and OECD simple averages of 26.2% and 17.3% respectively. The proposed change to a METR of 22.8%, which includes the impact of U.S. retail sales taxes on the capital purchases, would see the U.S. fall in its current ranking among OECD nations from the third to the seventh highest METR among the 34 nations.

The figure also illustrates that the proposal will benefit some industries more than others. This can be attributed to the



proposed changes to capital depreciation, in the form of full expensing for machinery, but not for land, inventories or structures. This means that firms, which are investing more heavily in machinery will see a greater tax reduction over the five years the measure applies. The incentive to increase capital investment, and thus stimulus, will also fall disproportionately on machinery intensive industries.

The Trump administration along with the Republican dominated House of Representatives and Senate both ran on platforms that promised major tax reforms. However, what appeared to be a long standing and similarly broad consensus on health care reform has failed to produce legislation. While Republicans are pressured to deliver on a major promise, we are left to wonder if divisions between the White House and Senate, or internally among Republicans will see tax reform on a similar rocky path.

**Policymakers should prepare for a potential loss in Canada's competitiveness.**